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IN THE

Supreme Court of the United States

October Term, 1943

No. ~~1051~~ 111

MARY STEVENS BAIRD,

Petitioner,

—*v.*—

ARTHUR H. FRANKLIN, Treasurer of the New York Stock Exchange, an Unincorporated Association of More Than Seven Persons.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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Mary Stevens Baird respectfully prays that a writ of certiorari be issued to review a judgment of the Circuit Court of Appeals for the Second Circuit affirming a judgment of the District Court for the Southern District of New York dismissing the complaint in the above entitled case.

Opinion Below.

The opinion of the Circuit Court of Appeals (R. 394-~~415~~ 411) which, by a divided court, affirmed the judgment of the District Court (R. 380 entered without opinion on findings of fact and conclusions of law, R. 341-358), is reported in 141 F. (2d) 238.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on March 27, 1944 (R. 41~~8~~3). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code (28 U. S. C. A. §347 (a)) as amended by the Act of February 13, 1925, 43 Stat. 938; and under the Securities Exchange Act of 1934; June 6, 1934, c. 404 §27, 48 Stat. 902; June 25, 1936, c. 804, 49 Stat. 1921 (15 U. S. C. A. §78(aa)).

Questions Presented.

1. This case presents for the first time the important federal question whether a registered national securities exchange "controls" its members within the meaning of Section 20(a) of the Securities Exchange Act. That Section provides that "Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, * * *".

The question arises upon the following basic facts. Petitioner was a customer of Richard Whitney and his firm, Richard Whitney & Co., members of the New York Stock Exchange. The business of Whitney and his firm was conducted in violation of the requirements of the Securities Exchange Act. Notice of such illegal conduct came to the attention of the New York Stock Exchange. In violation of its plain statutory duty the Exchange failed to expel, suspend or discipline Richard Whitney and Richard Whitney & Co. for "conduct or proceedings inconsistent with just and equitable principles of trade". Thereafter Richard Whitney and Richard Whitney & Co., while still members

in good standing of the New York Stock Exchange, fraudulently converted petitioner's securities. Petitioner asserts that respondent is liable jointly and severally with, and to the same extent as, Richard Whitney and Richard Whitney & Co.

2. Did the Circuit Court of Appeals for the Second Circuit commit reversible error in failing to apply to the facts of this case the doctrine announced by this Court in *The Pennsylvania*, 19 Wall. 125 (1873), it appearing that such application would render more effective the protection intended to be given to investors by the Securities Exchange Act.

In *The Pennsylvania* this Court pointed out that if a particular injury has been accompanied, and may have been caused, by a violation of a duty created in order to prevent such injuries, it is only a reasonable presumption that the violation was at least a contributory cause of the injury; and, accordingly, the burden in such a case rests upon the wrongdoer to show that his wrong not merely "might not have been one of the causes, or that it probably was not, but that it could not have been".

Application of that doctrine to the facts of this case would require a reversal of the judgment of the Circuit Court of Appeals for the Second Circuit.

The failure of the Circuit Court of Appeals to follow the decision of this Court in *The Pennsylvania, supra,* also probably conflicts with the decision of the Circuit Court of Appeals for the Tenth Circuit in *H. W. Bass Drilling Co.* v. *Ray,* 101 F. (2d) 316 (1939).

3. Did the Circuit Court of Appeals for the Second Circuit commit reversible error in holding that the New York Stock Exchange was not liable in damages on the sole ground that since the petitioner's securities were pledged on and prior to November 24, 1937, and thereafter were

released from pledge for but very short intervals, it was, in the absence of any further showing, a matter of pure speculation whether, if the Exchange had acted on November 24, 1937, the petitioner would have been able to retrieve her securities? (*Story Parchment Co.* v. *Paterson Co.*, 282 U. S. 555, 1931.)

The record shows (a) violation by the New York Stock Exchange, on and after November 24, 1937, of the duty it owed petitioner to expel, suspend or discipline Richard Whitney and Richard Whitney & Company when it learned that, in violation of the Securities Exchange Act and of the rules of the Exchange, they were illegally converting securities deposited with them by investors, (b) that thereafter, on January 26 and 28, 1938, petitioner's securities were in the hands of Whitney and his firm and were illegally pledged by them to secure loans to them from the Public National Bank and the New York Trust Company, respectively, and (c) that certain of the pledged securities were sold to satisfy these loans.

The day to day values of petitioner's securities at all material times were established by stipulation.

The Circuit Court of Appeals held that the damage suffered by petitioner had not been established with sufficient certainty, the Court stating: "It appears from the Record that by reason of unauthorized pledges the securities had all been converted prior to November 24, 1937, and were then in the possession of pledgee banks and so remained for some time thereafter, though at certain times all of them were returned to the pledgor and during the same day repledged to secure other loans. We can see no likelihood that the expulsion or suspension of Richard Whitney when his conversions came to the notice of the officers of the Exchange on November 24, 1937, would have in the least benefited the plaintiffs for the securities were then all converted and in the hands of pledgees" (R. 390 ~~(1049)~~). This

holding would require petitioner not only to show that on January 26 and 28, 1938, her securities were in the hands of and were converted by Richard Whitney and that this conversion caused her the partial loss established by the evidence, but also to establish whether and to what extent the securities that Whitney had theretofore illegally pledged would have been lost to her, assuming, contrary to the fact, that on November 24, 1937 the Exchange had suspended, expelled or disciplined Whitney.

Statute Involved.

The applicable provisions of the Act of June 6, 1934 c. 404, §1, 48 Stat. 881 (15 U. S. C. A. §78(a)) known as the Securities Exchange Act of 1934, are set out in the Appendix to this petition.

Statement.

This action arises under the Securities Exchange Act of 1934. It was brought to recover the damages which petitioner sustained by reason of the illegal hypothecation of her securities, in January 1938, by her brokers Richard Whitney and Richard Whitney & Co., members of respondent New York Stock Exchange.

The action is based upon the failure of respondent, when apprised in November 1937, that Whitney and his firm were violating the Act and respondent's own rules, to take any action to suspend, expel or discipline them as required under Section 6(b) of the Act, and also upon respondent's breach of its contract entered into under Section 6(a)(1) of the Act "to comply, and to enforce so far as is within its powers compliance by its members" with the Act. Petitioner also contends that under Section 20(a) of the Act, respondent's failure in good faith to enforce compliance with the Act by Whitney also rendered it liable co-extensively with Whit-

ney and his firm for the damages which she sustained by the latters' violations of the Act.

(A) ***The Facts.***

Between November 24, 1937 (and some months prior thereto) and January 28, 1938 Richard Whitney and Richard Whitney & Co. illegally, and without petitioner's knowledge or consent, pledged the securities which she had in a safekeeping account with said brokers, in a series of bank loans. The last of said loans, made on January 26 and 28, 1938, were foreclosed for nonpayment shortly after March 8, 1938 when Whitney and his firm were suspended from the respondent Exchange for inability to meet their commitments.

In and prior to November 1937 the Exchange itself, through the Trustees of its Gratuity Fund,[1] was also a customer of Richard Whitney and Richard Whitney & Co. On November 23, 1937 certain of said Trustees, who were also officers of the Exchange, learned that Whitney and his firm had misappropriated $221,000 in cash placed by the Trustees in their hands for investment, and, as the Circuit Court of Appeals found, at the same time learned facts from which they had reason to believe that Whitney and his firm had stolen $900,000 in securities belonging to the Fund then in their custody as brokers for the Fund, had been sending through the mails false statements of the Gratuity Fund account in aid of their hypothecations, and also were operating with less than the margin of liquid capital required by the Act.

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1 Under its Constitution the Exchange maintained a fund, known as the Gratuity Fund, which amounted in 1937 to some $2,000,000 in cash and securities, for the benefit of the families of deceased members. It was managed by seven Trustees "acting as agent for the Exchange" (Pliff's Ex. 2B, pp. 6-69, R. 71).

By prompt and firm action, the Exchange succeeded in obtaining the return of its cash and securities. Thereafter the Exchange deliberately (R. 136, 206) took no further action of any sort on the knowledge which it had thus received (R. 163), with the result that Whitney and his firm continued illegally pledging the petitioner's securities, as he had the respondent's, until the major portion of her securities were sold by the banks with which they had been unlawfully pledged.

During nine months before November 22, 1937, Whitney and his firm had purchased $700,000 in securities for the account of respondent's Gratuity Fund, in the course of a large re-investment program, and had also received from the Fund an additional $421,000 in cash and securities for purposes of reinvestment (Pltff's Exs. 22, 24, 30, R. 284, 286, 299). The monthly statements of account mailed to the respondent during this period indicated that its cash and securities were in the custody of Whitney and his firm free of any lien or claim (Pltff's Ex. 34, R. 305-315). Actually, Richard Whitney and Richard Whitney & Co. had unlawfully pledged these securities with the Corn Exchange Bank Trust Company to secure loans to themselves, and had misappropriated the cash (Pltff's Ex. 14, R. 260-261; R. 109, 210-212). The clerk of the Fund had, on at least five occasions during this time, asked Whitney to return the securities, but he had not done so (R. 99). Finally, on November 22, 1937, immediately following a special meeting of the Trustees of the Fund, E. H. H. Simmons, Chairman of the Trustees and a member of respondent's Board of Governors, called Whitney and demanded return of the securities and also the cash (R. 98, 110, 189, 190).

The following day Whitney came to Simmons and requested another day to meet the demand (R. 112, 191-193). Simmons refused (R. 112, 192). Whitney returned later in the day saying that he would return the cash and securities the next day and that, if Simmons needed any as-

surance, he had been over to see his brother George Whitney, then a partner of J. P. Morgan & Co. (R. 119, 194, 195). Simmons, as the result of these occurrences, then admittedly knew that Whitney had misappropriated the cash (R. 210-212) would, unless assisted by his brother, be suspended from the Exchange the next morning (R. 197, 208, 209), and, as found by the Circuit Court of Appeals, at least had reason to believe that Whitney had also stolen the securities. However, now knowing that George Whitney was aiding his brother, Simmons granted the additional time requested (R. 198).

The next day George lent his brother Richard the money necessary to pay the cash and redeem the securities, and the Exchange escaped without loss (R. 120, 121, 199, 200).

While respondent thus rescued its own property, petitioner's securities, which were, on November 22, 1937 also illegally pledged, a large portion with the Corn Exchange Bank Trust Company as were the respondent's, remained so pledged for some time (Pltff's Ex. 14, R. 267-273).

Misled, as had been the respondent, by the false statements sent her by Whitney (Pltff's Ex. 15, R. 69, 70 (not printed); Pltff's Ex. 14, R. 261), petitioner did not learn of the theft of her securities until after Whitney's collapse on March 8, 1938 (R. 68-70).

In the interim petitioner's securities had been pledged and repledged by Whitney in a succession of loans culminating with two loans on January 26 and 28, 1938 (Pltff's Ex. 14, R. 267-273) under which her securities were finally sold.

The only proof made by petitioner as to her damages was the market value of her pledged securities on each of the days between November 24, 1937 and the day on which the securities were finally sold[2]; the days on which her

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2 By stipulation, Plaintiff's Exhibit 46, offered and received at trial (R. 233), but not included in Record on Appeal.

securities were pledged between (and also prior to), November 24, 1937 and the final pledges on January 26 and 28, 1938, and the banks with which such securities were pledged (Pltff's Ex. 14, R. 267-273). Petitioner also showed that at some time during 22 of the 54 business days between November 24, 1937 and January 28, 1938 certain portions of her securities were redeemed from pledge by Whitney or his firm and were then in their possession and control before being repledged (Pltff's Ex. 14, R. 267-273; R. 148, 150, 152).

Respondent rested at the close of petitioner's case.

(B) *Decision of the Circuit Court of Appeals.*

The Circuit Court of Appeals, reversing contrary findings made by the District Court, found (R. 203 ~~105-106 (958-959)~~) that:

> "* * * on or about November 24, 1937, the Stock Exchange had knowledge that Richard Whitney or Richard Whitney & Co. was guilty of conduct inconsistent with just and equitable principles of trade, within the meaning of the Securities Exchange Act of 1934 and the Rules and Regulations of the Stock Exchange, in that he had converted to his own use cash belonging to the Gratuity Fund, had hypothecated for personal loans securities owned by that Fund, had failed to maintain the credit balance required by §8(b) of the Act, and had issued through the mails false statements regarding the Gratuity Fund account, in violation of §10(b) of the Act."

The Circuit Court of Appeals also concluded that when the Exchange, possessed of such knowledge, failed to take action to discipline Whitney, it clearly violated its duty implied in Section 6(b) of the Act to enforce its required rules: that this duty was imposed for the protection of in-

vestors and that the petitioner, as a member of that class, was entitled to maintain her action for damages resulting from breach of that duty.

Having so concluded, the Circuit Court stated it was unnecessary to consider the petitioner's second and alternative cause of action, namely, that the Exchange, in failing to act, also breached its express contract under Section 6(a)(1) of the Act; nor did the Court pass explicitly on the petitioner's contention that under Section 20(a) of the Act the Exchange as a person in control of its member Whitney had become liable to the petitioner, jointly with, and to the same extent as, Whitney, for the damages caused her by Whitney's violations of the Act.

A majority of the Circuit Court of Appeals, nevertheless, voted for affirmance of the judgment below, on the sole ground that since the petitioner's securities were pledged on and prior to November 24, 1937, and thereafter were released from pledge for but very short intervals, it was, in the absence of any further showing, a matter of pure speculation whether, if the Exchange had acted on November 24, 1937, the petitioner would have been able to retrieve her securities.

Judge Clark dissented and voted for reversal, concluding that the legal damage to the petitioner occurred as a result of the illegal repledging of her securities by Whitney *after* the Exchange was on notice of Whitney's illegal activities; that by establishing that the Exchange had knowledge of Whitney's illegal activities and had failed thereafter to discharge its statutory duty to check such activities and establishing her ultimate loss, the petitioner had made out a *prima facie* case. In his opinion, Judge Clark pointed out (R. ~~412 (966)~~ 409 et seq) that petitioner's difficulty in establishing the precise extent of her damages was solely attributable to the respondent's own wrongful failure to act, and that an exchange, once under a duty to act, should not by delaying,

or refraining from, action thereby be able to enhance its own chances of escape from the assertion of liability by those for whose protection it was under a duty to act.

Specification of Errors To Be Urged.

1. The Circuit Court of Appeals erred in holding that on the record presented the respondent was not liable to petitioner under the provisions of Section 20(a) of the Securities Exchange Act.

2. The Circuit Court of Appeals erred in failing to hold that to avoid liability for petitioner's loss, respondent was required to show that her loss was inevitable, even if respondent had performed its duty.

3. The Circuit Court of Appeals erred in holding that the petitioner on the record presented had not made out a prima facie case of damage proximately caused by the failure of the Exchange to take action against Whitney on or after November 24, 1937.

4. The Circuit Court of Appeals erred in failing to reverse the judgment below.

Reasons for Granting the Writ.

I.

In deciding that respondent was not liable jointly and severally with, and to the same extent as, Richard Whitney and Richard Whitney & Co., for their violations of the Act, the Circuit Court of Appeals has decided an important question of Federal law as to the interpretation of Section 20(a) of the Act which has not been, but should be settled by this Court.

Section 20(a) provides:

> "Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

The Courts below did not expressly pass on petitioner's contention, that the respondent exchange was liable jointly and severally with Whitney and his firm, under Section 20(a) of the Act. Liability *in solido* with Richard Whitney and Richard Whitney & Co. for their violation of the Act, both under Section 20(a) and at common law, was, nevertheless, asserted. Since such liability was asserted, the decision in respondent's favor necessarily includes a decision that respondent is not liable under Section 20(a). The opinion below being silent, the exact basis for this decision can be arrived at only by a process of elimination.

The Circuit Court of Appeals concluded that the earlier illegal pledgings of the Exchange's own securities, effectuated by means of false statements mailed to the Exchange, violated Sections 10(b), 8(c) and 8(d) of the Act. Thus, its decision that the Exchange was not liable under Section 20(a) could not have been based on any doubt that Whitney's final pledges of petitioner's securities, on January 26 and 28, 1938, and like mailing of false monthly statements to the petitioner, did not also violate the Act. Indisputably, as far as Richard Whitney and his firm are concerned, those violations of the Act caused, in a legal sense, petitioner's entire loss on foreclosure of the final pledges, and their

liability for the full amount of that loss is beyond dispute.

It can hardly be supposed, moreover, that the Circuit Court of Appeals considered the Exchange's inaction, when under a duty to act, and knowing that Whitney had been violating the Act in the most dishonest manner, to be consistent with good faith on the Exchange's part.

We thus reach the conclusion that the Circuit Court of Appeals must have decided that respondent did not "control" Richard Whitney and Richard Whitney & Co. within the meaning of Section 20 (a).

The term "control" is left undefined so that it must be given that meaning which will best effectuate the Congressional purposes in imposing a vicarious liability on controlling persons.

United States v. *Marshall Transport Co.*, 321 U. S. (No. 589.—October Term, 1943.)

Plainly, these were the same purposes which led to the adoption of the Act as a whole.

One of the prime purposes of the Congress, repeatedly declared throughout the Act, was to establish standards of conduct, for brokers and dealers in securities, which would protect their customers against their dishonesty, overreaching, or mere insolvency. To ensure adherence to these standards, duties were imposed on these brokers and dealers, for violations of which they are expressly or impliedly required to respond in damages. And a vicarious liability is imposed, by Section 20(a), on persons "controlling" these brokers and dealers, if in bad faith they fail to prevent, or if they actively induce, such violations of the Act.

The only "control" in which Congress could have been interested, when it imposed this vicarious liability, was the power to enforce adherence to the statutory standards and prevent violations of the correlative statutory duties. This

is precisely the control which exchanges are required to have and to exercise over their members. An exchange is required, by Section 6(b), to set up, and in appropriate cases to invoke, machinery for policing its members' compliance with the Act and other aspects of their business conduct. Under Section 6(a)(1) an exchange must undertake, so far as within its powers, to enforce its members' compliance with the Act. Section 6(d), provides no exchange may be registered under the Act unless its disciplinary rules are "just and adequate to insure fair dealing and to protect investors." All of these requirements were imposed to effectuate through the medium of the exchanges the regulation and "control" over their members' transactions which Section 2 expressly states the Act was intended to establish, in order, among other things, to protect investors.

The record clearly shows that the rules of respondent Exchange, if enforced, were just and adequate to insure fair dealing and to protect investors (Plff's Exs. 2A, 2B; Plff's Ex. 14, R. 259, 260); that respondent Exchange had set up machinery to police its members' business conduct in respect of their compliance with the Act and otherwise; and that by virtue of this machinery and these rules, the Exchange in fact had, and in most cases exercised, the requisite degree of control over the conduct of its members in their dealings with investors (R. 153, 154; 264-266).

Legislative history confirms the view that, as employed in Section 20(a), the term "control" was intended to be given whatever breadth of definition would best effectuate the purposes of the Act.

In some contexts the term means "legally enforceable control", but legislative history makes it entirely clear, that it was not so employed here. The House Committee Report (No. 1383, 73rd Cong. 2d Sess.), referring to *Handy & Harman* v. *Burnet,* 284 U. S. 136 (1931), expressly states (at

p. 26) that the term "control" as here employed is intended to include actual control, as well as what has been called "legally enforceable control".

The House Committee Report also makes it clear (at p. 26) that the term "control" was intended to have the most extended application possible, and that the Committee made no attempt to define it for the very reason that no definition could anticipate all of the possible ways in which control might be exercised.

Imposing liability on the Exchange, as a controlling person, for failure to exercise its control in good faith will create no hardship and inflict no injustice. On the contrary, in so doing, Section 20(a) merely conforms the legal duty of controlling persons to what has always been held to be their moral duty,—surely, as we understand it, an end properly to be achieved by legislation, and especially in the case of an exchange, which is forbidden to operate as an exchange unless it is in a position to control its members' conduct in their dealings with investors.

II.

In deciding that petitioner had failed to sustain the burden of proving that respondent's failure to perform its statutory and contractual duty contributed to her loss, it appearing that petitioner's injury may have been caused and was accompanied by such violation of the duty owed by respondent to petitioner to protect her against such injuries, the Circuit Court of Appeals has decided, in a way probably in conflict with applicable decisions of this Court, an important question of federal law which, if not settled by those decisions, has not been, but should be, settled by this Court. The decision of the Circuit Court of Appeals on this issue also probably conflicts with the decision of the Circuit Court of Appeals for the Tenth Circuit in *H. W. Bass Drilling Co. v. Ray*, 101 F. (2d) 316 (1939).

Although it knew on November 24, 1937 that its member Richard Whitney and his firm were violating the Securities Exchange Act of 1934 and its rules, respondent took no action to enforce their compliance with the Act or with its rules for more than three months. In failing to act sooner, respondent failed, as the Circuit Court of Appeals decided, to perform a duty impliedly imposed on it by the Act, in order to give customers of its members protection against injury from such members' violations of the Act and of respondent's rules required by the Act. Respondent's inaction was likewise a failure to perform a contractual duty assumed by it in its registration statement, for the same purpose.

Respondent's failure to perform these duties made possible the pledges of January 26 and 28, 1938, under which petitioner's securities were sold and was thus a cause in fact of the injury she actually suffered. Respondent nevertheless contended in the courts below that its violation of the Act, and of its contract, was not a proximate cause of petitioner's loss, arguing that even if respondent had acted when it first should have acted, petitioner's securities would probably have been lost to her under an earlier pledge. The majority of the Circuit Court of Appeals has so held and has affirmed the judgment of the District Court solely on this basis.

The effect of this holding by the Circuit Court of Appeals was to place on petitioner the burden of proving that she would not have suffered, in another way, if respondent had done its duty, the same loss which actually she did suffer because respondent had failed to do its duty.

We respectfully submit that under this Court's decision in *The Pennsylvania*, 19 Wall. 125 (1873) the burden of proof should instead have been placed on respondent, as the wrongdoer, to show, if it could, that petitioner would necessarily have suffered the same loss whatever respondent

might have done. As this Court pointed out in that case, if a particular injury has been accompanied, and may have been caused, by a violation of a duty created in order to prevent such injuries, it is only a reasonable presumption that the violation was at least a contributory cause of the injury; and, accordingly, the burden in such a case rests upon the wrongdoer to show that his wrong not merely "might not have been one of the causes, or that it probably was not, but that it could not have been".

The classic statement of the principle which this Court applied in *The Pennsylvania, supra,* and which we submit the Circuit Court of Appeals should have applied in the case at bar, is to be found in *Davis* v. *Garrett,* 6 Bing. 716 (C. P. 1830):

> "But we think the real answer to the objection is, that no wrong-doer can be allowed to apportion or qualify his own wrong; and that as a loss has actually happened whilst his wrongful act was in operation and force, and which is attributable to his wrongful act, he cannot set up as an answer to the action the bare possibility of a loss, if his wrongful act had never been done. It might admit of a different construction if he could shew, not only that the same loss might have happened, but that it must have happened if the act complained of had not been done; but there is no evidence to that extent in the present case."

See also:

> *The Aakre,* 122 F. (2d) 469 (C. C. A. 2d, 1941);
> *Morrison* v. *Shaw* [1916] 2 K. B. 783, 795.

Uncertainty created by respondent's wrongdoing it must, then, dispel at its peril to the extent of showing, as *Davis* v. *Garrett* puts it, that even if it had acted sooner, petitioner

must have suffered the same loss. On this Record, it is clear that no such showing has been made by petitioner. And it would seem that no such showing could ever be made by petitioner, since no one can say with certainty whether petitioner would have sustained any loss or what the amount of her loss would have been if respondent had acted earlier.

In *Leather Manufacturers' Bank* v. *Morgan*, 117 U. S. 96 (1886) this Court held that delay in notifying a bank of a forgery was enough to prevent an account stated from being opened up because it was impossible to say that the forger could not have made good the bank's loss, perhaps with the help of his family and friends, if the bank had known about the forgery sooner.

Similarly, in *State Street Trust Co.* v. *Ernst*, 278 N. Y. 104 (1938), the New York Court of Appeals held that proof of continuance of a loan in reliance upon a false balance sheet certified by defendant accountants made out a *prima facie* case of loss occasioned by certification of the false balance sheet, even though the credit had already been extended when the certification was made and (as in the case at bar) the pleadings established that the borrower was then insolvent.

Moreover, it can be urged with much force that even if respondent could do so successfully, respondent is estopped in the case at bar to deny that timely action by it would have saved petitioner harmless.

Respondent successfully recovered its own cash and securities on November 24, 1937, when they had been misappropriated and illegally pledged by Richard Whitney and his firm in the Corn Exchange Bank Trust Company. At this same time a large portion of petitioner's securities were also illegally pledged at the same bank. Respondent concealed from petitioner, when under a duty to her to take action that would have made the situation known, that

Richard Whitney and his firm had illegally pledged her securities and were unable (if they were then unable) to return them to her on demand. Respondent should not now be allowed to deny, what by its silence it then tacitly asserted: that on and after November 24, 1937, and at least until January 28, 1938, Richard Whitney and Richard Whitney & Co. were able to return petitioner's securities on demand, especially when they had proved able to return respondent's securities. (*Leather Manufacturers' Bank* v. *Morgan, supra.* See also *Va. Sec. Corp.* v. *Patrick Orchards*, 20 F. [2d] 78 [C. C. A. 4, 1927] and *Comm. National Bank* v. *Nacogdoches Co.*, 133 Fed. 501 [C. C. A. 5, 1904].)

Although *The Pennsylvania* (*supra*) was an admiralty case, neither it nor *Davis* v. *Garrett* (*supra*) was based on principles peculiar to the maritime law, and other courts have considered the principles there applied equally applicable in non-maritime cases.

> *H. W. Bass Drilling Co.* v. *Ray, supra;*
> *Martin* v. *Herzog*, 228 N. Y. 164 (1920);
> *U. S. Trust Co.* v. *O'Brien*, 143 N. Y. 284 (1894);
> *A/S Rendal* v. *Arcos, Ltd.*, 106 L. J. K. B. [N. S.] 756 (1937);
> cf. *State Street Trust Co.* v. *Ernst, supra.*

Allocation of the burden of proof will in most cases determine whether the statute or contract involved will give the substance or merely the shadow of the protection it was designed to afford.

By placing that burden on petitioner, the majority of the Circuit Court of Appeals has deprived her of any real protection and relieved respondent of any real responsibility under the Act, or respondent's contract. As Judge Clark in his dissent pointed out (R. ~~1134 (966-7)~~)):

"* * * Any other rule [i.e., other than the rule for which petitioner contends] seemingly imposes little responsbility upon the Exchange for carrying out the duty which we have found the Act to place upon it, and even provides an incentive, after the Exchange has become aware of a serious condition, for it to let matters drift, while it and its members having special knowledge protect themselves just as they did here—a result which, to my mind, borders on the immoral, in that it encourages a fiduciary to safeguard its own private interests while it allows its beneficiaries to suffer."

III.

In holding that the New York Stock Exchange was not liable in damages on the sole ground that since the petitioner's securities were pledged on and prior to November 24, 1937, and thereafter were released from pledge for but very short intervals, it was, in the absence of any further showing, a matter of pure speculation whether, if the Exchange had acted on November 24, 1937, the petitioner would have been able to retrieve her securities, the Circuit Court of Appeals has decided a question of federal law in a way probably in conflict with applicable decisions of this Court.

Petitioner proved her ownership of the securities she lost, their values at all material times (R. 233), that they were unlawfully pledged on January 26 and 28, 1938, that certain of them were sold to satisfy the loans for which they were pledged and others recovered by petitioner, and that petitioner was also entitled to a share in $5,376.79 proceeds of excess collateral sold.[3]

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3 Plaintiff's Exhibit 14, Record 263. Plaintiff's pro rata share in such securities has since been fixed at $1550.67 by judgment in *New York Yacht Club* v. *Central Hanover Bank & Trust Co.*

There can be no doubt, that no matter who had the ultimate burden of proof, petitioner by this proof made out a *prima facie* case for recovery of the full amount of her loss,—that is, that she proved facts entitling her to judgment in that amount, unless additional facts were proved showing that no damage or a lesser amount of damage had resulted from respondent's wrong.

Certain additional facts were proved:

First, it was proved that petitioner's securities were pledged with other banks on November 24, 1937, and on some part of every day thereafter, until their final pledge. (Plff's Ex. No. 14, R. 267-273.) (But there was no proof as to the amount of the loans for which the pledges were made, the amount of other collateral lawfully pledged to secure them, or even as to whether the pledgees were holders in due course of petitioner's securities. And it was proved that part or all of petitioner's securities were in the hands of Whitney and his firm during part of each of 22 out of the 52 business days between November 24, 1936 and January 26, 1938. (Plff's Ex. No. 14, R. 267-273; R. 148, 150, 152.))

Second, it was alleged in the complaint, although denied in the answer that on November 24, 1937 the Exchange knew that Whitney and his firm were insolvent (R. 7-12, 27-29, 37, 40, 42, 45, 54-57). (But there was no proof as to the extent of their insolvency at any time, as bearing on their ability either to redeem petitioner's securities from previous pledges or to respond in damages. And it was proved, that Richard Whitney was able to borrow from his brother George on November 24, 1937, the amount necessary to redeem respondent's securities and repay respondent's cash which he and his firm had misappropriated. And it was also proved that Richard Whitney and Richard Whitney & Co. were able to redeem petitioner's securities from each of their earlier pledges: i.e., by proving that they did in fact redeem them.)

It may be, that the Circuit Court of Appeals unconsciously assumed that "insolvency" might be equated to a complete lack of assets and borrowing ability, and "pledge" equated to certain loss. Its decision not to order a new trial would seem to indicate that something of the sort must have occurred. But the fact remains, that neither of these assumptions can be regarded as axiomatic and there is nothing in the Record to indicate that either, and much to indicate that neither, of them could justifiably be made in the case at bar.

If one wishes to speculate, the more probable assumption is, that some, at least of the earlier pledges would have resulted in no loss at all to petitioner:

Whitney and his firm were personally obligated to exonerate petitioner's securities, and if called upon to do so, might have responded, even though insolvent.

Petitioner was entitled to exoneration or indemnity from securities lawfully pledged along with her securities.[4] In those instances where the security lawfully pledged was enough to cover the loan, the unlawful pledge of petitioner's securities subjected them to no real burden. Even under the final pledges of January 26 and January 28, petitioner got back in this way a quarter of what she had at stake, and if certain of the other securities involved had not been illegally pledged she would have fared still better,—in itself a sufficient answer to the suggestion that "pledge" meant necessarily a total loss.

Finally, an illegal pledge imposes no burden at all, unless the pledgee is a holder in due course, as presumptively he is not.

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4 Under *Asylum of St. Vincent de Paul* v. *McGuire*, 239 N. Y. 375 (1925) petitioner was also entitled to contribution in equity from securities of others unlawfully pledged along with hers to the extent that she bore more than her pro rata share of the loss.

Nevertheless, it must be conceded that proof of these additional facts did create some uncertainty as to the extent of petitioner's damage.

Assuming, for the sake of the present argument, that respondent did not "control" Whitney, and was not required to show that its wrong could not have contributed to petitioner's loss, the burden of going forward with evidence to resolve this uncertainty logically must rest on whichever party should bear the risk of the uncertainty. Since the uncertainty was created by respondent's wrongful act, the decision of this Court in *Story Parchment Co.* v. *Paterson Co.* (282 U. S. 555, 1931) requires that respondent bear this risk, and the decision of the Circuit Court of Appeals placing it on petitioner is, we submit, in conflict with that decision.

CONCLUSION.

It is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIX

SEC. 2. For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

SEC. 6.(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder;

SEC. 6.(b) No registration shall be granted or remain in force unless the rules of the exchange include provision

for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the wilful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

SEC. 6.(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

SEC. 8. It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly—

SEC. 8.(b) To permit in the ordinary course of business as a broker his aggregate indebtedness to all other persons, including customers' credit balances (but excluding indebtedness secured by exempted securities), to exceed such percentage of the net capital (exclusive of fixed assets and value of exchange membership) employed in the business, but not exceeding in any case 2,000 per centum, as the Commission may be rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors.

(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer

under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer, (2) that will permit such securities to be commingled with the securities of any person other than a bona fide customer, or (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities.

(d) To lend or arrange for the lending of any securities carried for the account of any customer without the written consent of such customer.

Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Sec. 3. (a) When used in this title, unless the context otherwise requires—

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

Sec. 15. (c) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the pur-

chase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

SEC. 20.(a) Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

SEC. 28.(a) The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

(b) Nothing in this title shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on

any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this title or the rules and regulations thereunder.

Rule X-15C 1-2:

(a) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c) (1) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(b) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c) (1) of the Act, is hereby defined to include any untrue statement of material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(13)

IN THE

Supreme Court of the United States

October Term, 1943

No. 1052 112

THE NEW YORK YACHT CLUB,

Petitioner,

—*v.*—

ARTHUR H. FRANKLIN, Treasurer of the New York Stock Exchange, an Unincorporated Association of More Than Seven Persons.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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Law Brief Press—NYC

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IN THE

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THE NEW YORK YACHT CLUB,

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ARTHUR H. FRANKLIN, Treasurer of the New York Stock Exchange, an Unincorporated Association of More Than Seven Persons.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The New York Yacht Club respectfully prays that a writ of certiorari be issued to review a judgment of the Circuit Court of Appeals for the Second Circuit affirming a judgment of the District Court for the Southern District of New York dismissing the complaint in the above entitled case.

Opinion Below.

The opinion of the Circuit Court of Appeals (R. 394-411) which, by a divided court, affirmed the judgment of the District Court (R. 379, entered without opinion on findings of fact and conclusions of law, R. 341-358), is reported in 141 Fed. (2d) 238.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on March 27, 1944 (R. 412). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code (28 U. S. C. A. §347 (a)) as amended by the Act of February 13, 1925, 43 Stat. 938; and under the Securities Exchange Act of 1934; June 6, 1934, c. 404 §27, 48 Stat. 902; June 25, 1936, c. 804, 49 Stat. 1921 (15 U. S. C. A. §78aa).

Questions Presented.

1. This case presents for the first time the important federal question whether a registered national securities exchange "controls" its members within the meaning of Section 20 (a) of the Securities Exchange Act. That Section provides that "Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, * * * ".

The question arises upon the following basic facts. Petitioner was a customer of Richard Whitney and his firm, Richard Whitney & Co., members of the New York Stock Exchange. The business of Whitney and his firm was conducted in violation of the requirements of the Securities Exchange Act. Notice of such illegal conduct came to the attention of the New York Stock Exchange. In violation of its plain statutory duty the Exchange failed to expel, suspend or discipline Richard Whitney and Richard Whitney & Co. for "conduct or proceedings inconsistent with just and equitable principles of trade." Thereafter Richard Whitney and Richard Whitney & Co., while still members in

good standing of the New York Stock Exchange, fraudulently converted petitioner's securities. Petitioner asserts that respondent is liable jointly and severally with, and to the same extent as, Richard Whitney and Richard Whitney & Co.

2. Did the Circuit Court of Appeals for the Second Circuit commit reversible error in failing to apply to the facts of this case the doctrine announced by this Court in *The Pennsylvania,* 19 Wall. 125 (1873) it appearing that such application would render more effective the protection intended to be given to investors by the Securities Exchange Act.

In *The Pennsylvania* this Court pointed out that if a particular injury has been accompanied, and may have been caused, by a violation of a duty created in order to prevent such injuries, it is only a reasonable presumption that the violation was at least a contributory cause of the injury; and, accordingly, the burden in such a case rests upon the wrongdoer to show that his wrong not merely "might not have been one of the causes, or that it probably was not, but that it could not have been."

Application of that doctrine to the facts of this case would require a reversal of the judgment of the Circuit Court of Appeals for the Second Circuit.

The failure of the Circuit Court of Appeals to follow the decision of this Court in *The Pennsylvania supra* also probably conflicts with the decision of the Circuit Court of Appeals for the Tenth Circuit in *H. W. Bass Drilling Co.* v. *Ray,* 101 Fed. 2d, 316, (1939).

3. Did the Circuit Court of Appeals for the Second Circuit commit reversible error in holding that the New York Stock Exchange was not liable in damages on the sole ground that since the petitioner's securities were pledged on and prior to November 24, 1937, and thereafter were

released from pledge for but very short intervals, it was, in the absence of any further showing, a matter of pure speculation whether, if the Exchange had acted on November 24, 1937, the petitioner would have been able to retrieve its securities? (*Story Parchment Co.* v. *Paterson Parchment Company,* 282 U. S. 555, 1931.)

The record shows (a) violation by the New York Stock Exchange, on and after November 24, 1937, of the duty it owed petitioner to expel, suspend or discipline Richard Whitney and Richard Whitney & Company when it learned that, in violation of the Securities Exchange Act and of the rules of the Exchange, they were illegally converting securities deposited with them by investors, (b) that thereafter, on January 26 and 28, 1938, petitioner's securities and those of others were in the hands of Whitney and his firm and were illegally pledged by them to secure loans to them from the Public National Bank and Trust Company, and (c) that certain of the pledged securities and all of petitioner's securities were sold to satisfy these loans.

Petitioner's securities were sold for $105,184.13.

The Circuit Court of Appeals held that the damage suffered by petitioner had not been established with sufficient certainty, the Court stating: "It appears from the Record that by reason of unauthorized pledges the securities had all been converted prior to November 24, 1937, and were then in the possession of pledgee banks and so remained for some time thereafter, though at certain times all of them were returned to the pledgor and during the same day repledged to secure other loans. We can see no likelihood that the expulsion or suspension of Richard Whitney when his conversions came to the notice of the officers of the Exchange on November 24, 1937, would have in the least benefited the plaintiffs for the securities were then all converted and in the hands of pledgees" (R. 395). This holding would require petitioner not only to show that

on January 26 and 28, 1938, its securities were in the hands of and were converted by Richard Whitney and that this conversion caused to it the total loss established by the evidence, but also to establish whether and to what extent the petitioner's securities that Whitney had theretofore illegally pledged would have been lost, assuming, contrary to the fact, that on November 24, 1937 the Exchange had suspended, expelled or disciplined Whitney.

Statute Involved.

The applicable provisions of the Act of June 6, 1934 c. 404, §1, 48 Stat. 881 (15 U. S. C. A. §78(a)) known as the Securities Exchange Act of 1934, are set out in the Appendix to this petition.

Statement.

This action arises under the Securities Exchange Act of 1934. It was brought to recover the damages which petitioner sustained by reason of the illegal hypothecation of its securities in January, 1938, by Richard Whitney and Richard Whitney & Co., members of respondent New York Stock Exchange.

The action is based upon the failure of respondent, when apprised in November 1937, that Whitney and his firm were violating the Act and respondent's own rules, to take any action to suspend, expel or discipline them as required under Section 6(b) of the Act, and also upon respondent's breach of its contract entered into under Section 6(a)(1) of the Act "to comply, and to enforce so far as is within its powers compliance by its members" with the Act. Petitioner also contends that under Section 20(a) of the Act, respondent's failure in good faith to enforce compliance with the Act by Whitney also rendered it liable co-extensively with Whitney and his firm for the damages which the Club sustained by the latters' violations of the Act.

(A) *The Facts.*

Between November 24, 1937 (and some months prior thereto) and January 28, 1938 Richard Whitney and Richard Whitney & Co. illegally, and without petitioner's knowledge or consent, pledged the securities which Richard Whitney, as Treasurer of the Club, had in his possession in a series of bank loans. The last of said loans, made on January 26 and 28, 1938, were foreclosed for nonpayment shortly after March 8, 1938 when Whitney and his firm were suspended from the Exchange for inability to meet their commitments.

In and prior to November 1937 the Exchange itself, through the Trustees of its Gratuity Fund,[1] was also a customer of Richard Whitney and Richard Whitney & Co. On November 23, 1937 certain of said Trustees, who were also officers of the Exchange, learned that Whitney and his firm had misappropriated $221,000 in cash placed by the Trustees in their hands for investment, and, as the Circuit Court of Appeals found, at the same time learned facts from which they had reason to believe that Whitney and his firm had stolen $900,000 in securities belonging to the Fund then in their custody as brokers for the Fund; had been sending through the mails false statements of the Gratuity Fund account to conceal their hypothecations, and also were operating with less than the margin of liquid capital required by the Act.

By prompt and firm action, the Exchange succeeded in obtaining the return of its cash and securities. Thereafter the Exchange deliberately (R. 136, 206) took no further

1 Under its Constitution the Exchange maintained a fund, known as the Gratuity Fund, which amounted in 1937 to some $2,000,000 in cash and securities, for the benefit of the families of deceased members. It was managed by seven Trustees "acting as agent for the Exchange" (Plff's Ex. 2B, pp. 6-69, R. 70).

action of any sort on the knowledge which it had thus received (R. 163, fol. 488), with the result that Whitney and his firm continued illegally pledging the petitioner's securities, as he had the respondent's, until all the Clubs' securities were sold by the bank with which they had been unlawfully pledged.

During nine months before November 22, 1937, Whitney and his firm had purchased $700,000 in securities for the account of respondent's Gratuity Fund, in the course of a large re-investment program, and had also received from the Fund an additional $421,000 in cash and securities for purposes of reinvestment (Pltff's Exs. 22, 24, 30, R. 284, 286, 299). The monthly statements of account mailed to the respondent during this period indicated that its cash and securities were in the custody of Whitney and his firm free of any lien or claim (Pltff's Ex. 34, R. 305-315). Actually, Richard Whitney and Richard Whitney & Co. had unlawfully pledged these securities with the Corn Exchange Bank Trust Company to secure loans to themselves, and had misappropriated the cash (Pltff's Ex. 14, R. 260-261; R. 109, 210-212). The clerk of the Fund had, on at least five occasions during this time asked Whitney to return the securities, but he had not done so (R. 99). Finally, on November 22, 1937, immediately following a special meeting of the Trustees of the Fund, E. H. H. Simmons, Chairman of the Trustees and a member of respondent's Board of Governors, called Whitney and demanded return of the securities and also the cash (R. 98, 110, 189, 190).

The following day Whitney came to Simmons and requested another day to meet the demand (R. 112, 191-193). Simmons refused (R. 112, 192). Whitney returned later in the day saying that he would return the cash and securities the next day and that if Simmons needed any assurance he had been over to see his brother George Whitney,

then a partner of J. P. Morgan & Co. (R. 119, 194, 195). Simmons, as the result of these occurrences, then admittedly knew that Whitney had misappropriated the cash (R. 210-212); would, unless assisted by his brother, be suspended from the Exchange the next morning (R. 197, 208, 209), and, as found by the Circuit Court of Appeals, at least had reason to believe that Whitney had also stolen the securities. However, now knowing that George Whitney was aiding his brother, Simmons granted the additional time requested (R. 198).

The next day George lent his brother Richard the money necessary to pay the cash and redeem the securities, and the Exchange escaped without loss (R. 120, 121, 199, 200).

While respondent thus rescued its own property, petitioner's securities, which were, on November 22, 1937 also illegally pledged with the Corn Exchange Bank Trust Company as were the respondent's, remained so pledged in the same loan until December 1, 1937 (Pltff's Ex. 4, R. 243-253).

Misled, as had been the respondent, by the false statements sent by Whitney (Plff's Ex. 6 (not printed, but original submitted to Circuit Court of Appeals on argument)); petitioner did not learn of the theft of its securities until after Whitney's collapse on March 8, 1938 (R. 65, 66).

In the interim petitioner's securities had been pledged and repledged by Whitney in a succession of loans culminating with two loans on January 26 and 28, 1938 (Pltff's Ex. 4, R. 250-253).

The only proof made by petitioner as to damages was the market value of its pledged securities on the day on which the securities were finally sold (viz: $105,184.13, R. 46, 47); and the banks with which such securities were pledged (Pltff's Ex. 4, R. 250-253). Petitioner also showed that at various times between November 24, 1937 and January 28, 1938 its securities were redeemed from pledge

by Whitney or his firm and were then in their possession and control before being repledged (Pltff's Ex. 4, R. 250-253; R. 150, 152).

Respondent rested at the close of the plaintiff's case.

(B) ***Decision of the Circuit Court of Appeals.***

The Circuit Court of Appeals, reversing contrary findings made by the District Court, found (R. 403) that:

> "* * * on or about November 24, 1937, the Stock Exchange had knowledge that Richard Whitney or Richard Whitney & Co. was guilty of conduct inconsistent with just and equitable principles of trade, within the meaning of the Securities Exchange Act of 1934 and the Rules and Regulations of the Stock Exchange, in that he had converted to his own use cash belonging to the Gratuity Fund, had hyphothecated for personal loans securities owned by that Fund, had failed to maintain the credit balance required by §8(b) of the Act, and had issued through the mails false statements regarding the Gratuity Fund account, in violation of §10(b) of the Act."

The Circuit Court of Appeals also concluded that when the Exchange, possessed of such knowledge, failed to take action to discipline Whitney, it clearly violated its duty implied in Section 6(b) of the Act to enforce its required rules for the protection of investors: that this duty was imposed for the protection of investors and that the petitioner, as a member of that class, was entitled to maintain its action for damages resulting from breach of that duty.

Having so concluded, the Circuit Court stated it was unnecessary to consider the petitioner's second and alternative cause of action, namely, that the Exchange, in failing to act, also breached its express contract under Section 6(a)(1)

of the Act; nor did the Court pass explicitly on the petitioner's contention that under Section 20(a) of the Act the Exchange as a person in control of its member Whitney had become liable to the petitioner, jointly with, and to the same extent as, Whitney, for the damages caused by Whitney's violations of the Act.

A majority of the Circuit Court of Appeals, nevertheless, voted for affirmance of the judgment below, on the sole ground that since the petitioner's securities were pledged on and prior to November 24, 1937, and thereafter were released from pledge for but very short intervals, it was, in the absence of any further showing, a matter of pure speculation whether, if the Exchange had acted on November 24, 1937, the petitioner would have benefited "for the securities were then all converted and in the hands of pledgees" (R. 395).

Judge Clark dissented and voted for reversal, holding that the legal damage to the petitioner occurred as a result of the illegal repledging of its securities by Whitney *after* the Exchange was on notice that Whitney was so engaged; that by establishing that the Exchange had knowledge of Whitney's illegal activities and had failed thereafter to discharge its statutory duty to check such activities and its ultimate loss, the petitioner had made out a *prima facie* case. In his opinion, Judge Clark pointed out (R. 409) that petitioner's difficulty in establishing the precise extent of its damages was solely attributable to the respondent's own wrongful failure to act, and that an exchange, once under a duty to act, should not by delaying, or refraining from, action thereby be able to enhance its own chances of escape from the assertion of liability by those for whose protection it was under a duty to act.

Specification of Errors To Be Urged.

1. The Circuit Court of Appeals erred in holding that on the record presented the respondent was not liable to petitioner under the provisions of Section 20(a) of the Securities Exchange Act.

2. The Circuit Court of Appeals erred in failing to hold that to avoid liability for petitioner's loss, respondent was required to show that its loss was inevitable, even if respondent had performed its duty.

3. The Circuit Court of Appeals erred in holding that the petitioner on the record presented had not made out a prima facie case of damage proximately caused by the failure of the Exchange to take action against Whitney on or after November 24, 1937.

4. The Circuit Court of Appeals erred in failing to reverse the judgment below.

Reasons for Granting the Writ.

I.

In deciding that respondent was not liable jointly and severally with, and to the same extent as, Richard Whitney and Richard Whitney & Co., for their violations of the Act, the Circuit Court of Appeals has decided an important question of Federal law as to the interpretation of Section 20(a) of the Act which has not been, but should be settled by this Court.

Section 20(a) provides:

> "Sec. 20(a) Every person who, directly or indirectly, controls any person liable under any provision of this

> title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

The Courts below did not expressly pass on petitioner's contention, that the respondent exchange was liable jointly and severally with Whitney and his firm, under Section 20(a) of the Act. Liability *in solido* with Richard Whitney and Richard Whitney & Co. for their violation of the Act, both under Section 20(a) and at common law, was, nevertheless, asserted. Since such liability was asserted, the decision in respondent's favor necessarily includes a decision that respondent is not liable under Section 20(a). The opinion below being silent, the exact basis for this decision can be arrived at only by a process of elimination.

The Circuit Court of Appeals concluded that the earlier illegal pledgings of the Exchange's own securities, effectuated by means of false statements mailed to the Exchange, violated Sections 10(b), 8(c) and 8(d) of the Act. Thus, its decision that the Exchange was not liable under Section 20(a) could not have been based on any doubt that Whitney's final pledges of petitioner's securities, on January 26 and 28, 1938, and like mailing of false monthly statements to the petitioner, did not also violate the Act. Indisputably, as far as Richard Whitney and his firm are concerned, those violations of the Act caused, in a legal sense, petitioner's entire loss on foreclosure of the final pledges, and their liability for the full amount of that loss is beyond dispute.

It can hardly be supposed, moreover, that the Circuit Court of Appeals considered the Exchange's inaction, when under a duty to act, and knowing that Whitney had been

violating the Act in the most dishonest manner, to be consistent with good faith on the Exchange's part.

We thus reach the conclusion that the Circuit Court of Appeals must have decided that respondent did not "control" Richard Whitney and Richard Whitney & Co. within the meaning of Section 20 (a).

The term "control" is left undefined so that it must be given that meaning which will best effectuate the Congressional purposes in imposing a vicarious liability on controlling persons.

> *United States* v. *Marshall Transport Co.*, 321 U. S. (No. 589, October Term, 1943).

Plainly, these were the same purposes which led to the adoption of the Act as a whole.

One of the prime purposes of the Congress, repeatedly declared throughout the Act, was to establish standards of conduct, for brokers and dealers in securities, which would protect their customers against their dishonesty, overreaching, or mere insolvency. To insure adherence to these standards, duties were imposed on these brokers and dealers, for violations of which they are expressly or impliedly required to respond in damages. And a vicarious liability is imposed, by Section 20(a), on persons "controlling" these brokers and dealers, if in bad faith they fail to prevent, or if they actively induce, such violations of the Act.

The only "control" in which Congress could have been interested, when it imposed this vicarious liability, was the power to enforce adherence to the statutory standards and prevent violations of the correlative statutory duties. This is precisely the control which exchanges are required to have and to exercise over their members. An exchange is required, by Section 6(b), to set up, and in appropriate cases to invoke, machinery for policing its members' com-

pliance with the Act and other aspects of their business conduct. Under Section 6(a)(1) an exchange must undertake, so far as within its powers, to enforce its members' compliance with the Act. Section 6(d) provides that no exchange may be registered under the act unless its disciplinary rules are "just and adequate to insure fair dealing and to protect investors." All of these requirements were imposed to effectuate through the medium of the exchanges the regulation and "control" over their members' transactions which Section 2 expressly states the Act was intended to establish in order, among other things, to protect investors.

The record clearly shows that the rules of respondent Exchange, if enforced, were just and adequate to insure fair dealing and to protect investors (Plff's Exs. 2A, 2B); that respondent Exchange had set up machinery to police its members' business conduct in respect of their compliance with the Act and otherwise; and that by virtue of this machinery and these rules, the Exchange in fact had, and in most cases exercised, the requisite degree of control over the conduct of its members in their dealings with investors (R. 153, 154; 264-266).

Legislative history confirms the view that, as employed in Section 20 A, the term "control" was intended to be given whatever breadth of definition would best effectuate the purposes of the Act.

In some contexts the term means "legally enforceable control", but legislative history makes it entirely clear, that it was not so employed here. The House Committee Report (No. 1383, 73rd Cong. 2d Sess.), referring to *Handy & Harman* v. *Burnet,* 284 U. S. 1366 (1931), expressly states (at p. 26) that the term "control" as here employed is intended to include actual control, as well as what has been called "legally enforceable control".

The House Committee Report also makes it clear (at p. 26) that the term "control" was intended to have the

most extended application possible, and that the Committee made no attempt to define it for the stated reason that no definition could anticipate all of the possible ways in which control might be exercised.

Imposing liability on the Exchange, as a controlling person, for failure to exercise its control in good faith will create no hardship and inflict no injustice. On the contrary, in so doing, Section 20(a) merely conforms the legal duty of controlling persons to what has always been held to be their moral duty,—surely, as we understand it, an end properly to be achieved by legislation, and especially in the case of an exchange, which is forbidden to operate as an exchange unless it is in a position to control its members' conduct in their dealings with investors.

II.

In deciding that petitioner had failed to sustain the burden of proving that respondent's failure to perform its statutory and contractual duty contributed to its loss, it appearing that petitioner's injury may have been caused and was accompanied by such violation of the duty owed by respondent to petitioner to protect it against such injuries, the Circuit Court of Appeals has decided, in a way probably in conflict with applicable decisions of this Court, an important question of federal law which, if not settled by those decisions, has not been, but should be, settled by this Court. The decision of the Circuit Court of Appeals on this issue also probably conflicts with the decision of the Circuit Court of Appeals for the Tenth Circuit in *H. W. Bass Drilling Co.* v. *Ray*, 101 F. (2d) 316 (1939).

Although it knew on November 24, 1937 that its member Richard Whitney and his firm were violating the Securities Exchange Act of 1934 and its rules, respondent took no action to enforce their compliance with the Act or with its rules for more than three months. In failing to act sooner,

respondent failed, as the Circuit Court of Appeals decided, to perform a duty impliedly imposed on it by the Act, in order to give customers of its members protection against injury from such members' violations of the Act and of respondent's rules required by the Act. Respondent's inaction was likewise a failure to perform a contractual duty assumed by it in its registration statement, for the same purpose.

Respondent's failure to perform these duties made possible the pledges of January 26 and 28, 1938, under which petitioner's securities were sold and was thus a cause in fact of the injury the Club actually suffered. Respondent nevertheless contended in the courts below that its violation of the Act, and of its contract, was not a proximate cause of petitioner's loss, arguing that even if respondent had acted when it first should have acted, petitioner's securities would probably have been lost under an earlier pledge. The majority of the Circuit Court of Appeals has so held and has affirmed the judgment of the District Court solely on this basis.

The effect of this holding by the Circuit Court of Appeals was to place on petitioner the burden of proving that it would not have suffered, in another way, if respondent had done its duty, the same loss which actually it did suffer because respondent had failed to do its duty.

We respectfully submit that under this Court's decision in *The Pennsylvania,* 19 Wall. 125 (1873) the burden of proof should instead have been placed on respondent, as the wrongdoer, to show, if it could, that petitioner would necessarily have suffered the same loss whatever respondent might have done. As this Court pointed out in that case, if a particular injury has been accompanied, and may have been caused, by a violation of a duty created in order to prevent such injuries, it is only a reasonable presumption that the violation was at least a contributory cause of the

injury; and, accordingly, the burden in such a case rests upon the wrongdoer to show that his wrong not merely "might not have been one of the causes, or that it probably was not, but that it could not have been".

The classic statement of the principle which this Court applied in *The Pennsylvania, supra,* and which we submit the Circuit Court of Appeals should have applied in the case at bar, is to be found in *Davis* v. *Garrett,* 6 Bing. 716 C. P. (1830):

> "But we think the real answer to the objection is, that no wrong-doer can be allowed to apportion or qualify his own wrong; and that as a loss has actually happened whilst his wrongful act was in operation and force, and which is attributable to his wrongful act, he cannot set up as an answer to the action the bare possibility of a loss, if his wrongful act had never been done. It might admit of a different construction if he could shew, not only that the same loss might have happened, but that it must have happened if the act complained of had not been done; but there is no evidence to that extent in the present case."

See also:

> *The Aakre,* 122 F. (2d) 469 (C. C. A. 2d, 1941);
> *Morrison* v. *Shaw,* [1916] 2 K. B. 783, 795.

Uncertainty created by respondent's wrongdoing it must, then, dispel at its peril to the extent of showing, as *Davis* v. *Garrett* puts it, that even if it had acted, petitioner *must* have suffered the same loss. On this Record, it is clear that no such showing has been made by petitioner. And it would seem that no such showing could ever be made by petitioner, since no one can say with certainty whether

petitioner would have sustained any loss or what the amount of its loss would have been if respondent had acted.

In *Leather Manufacturer's Bank* v. *Morgan,* 117 U. S. 96 (1886) this Court held that delay in notifying a bank of a forgery was enough to prevent an account stated from being opened up because it was impossible to say that the forger could not have made good the bank's loss, perhaps with the help of his family and friends, if the bank had known about the forgery sooner.

Similarly, in *State Street Trust Co.* v. *Ernst,* 278 N. Y. 104 (1938), the New York Court of Appeals held that proof of continuance of a loan in reliance upon a false balance sheet certified by defendant accountants made out a *prima facie* case of loss occasioned by certification of the false balance sheet, even though the credit had already been extended when the certification was made and (as in the case at bar) the pleadings established that the borrower was then insolvent.

Moreover, it can be urged with much force that even if respondent could do so successfully, respondent is estopped in the case at bar to deny that timely action by it would have saved petitioner harmless.

Respondent successfully recovered its own cash and securities on November 24, 1937, when they had been misappropriated and illegally pledged by Richard Whitney and his firm in the Corn Exchange Bank Trust Company. At this same time all of petitioner's securities were also illegally pledged at the same bank. Respondent concealed from petitioner, when under a duty to take action that would have made the situation known, that Richard Whitney and his firm had illegally pledged its securities and were unable (if they were then unable) to return them on demand. Respondent should not now be allowed to deny, what by its silence it then tacitly asserted: that on and after November 24, 1937, and at least until January 28, 1938, Richard

Whitney and Richard Whitney & Co. were able to return petitioner's securities on demand, especially when they had proved able to return respondent's securities. [(*Leather Manufacturer's Bank* v. *Morgan, supra.* See also *Va. Sec. Corp.* v. *Patrick Orchards,* 20 F. (2d) 78 (C. C. A. 4, 1927) and *Comm. National Bank* v. *Nacogoloches Co.,* 133 Fed. 501 (C. C. A. 5, 1941)].

Although *The Pennsylvania* (*supra*) was an admiralty case, neither it nor *Davis* v. *Garrett* (*supra*) was based on principles peculiar to the maritime law, and other courts have considered the principles there applied equally applicable in non-maritime cases.

> *H. W. Bass Drilling Co.* v. *Ray, supra;*
> *Martin* v. *Herzog,* 228 N. Y. 164 (1920);
> *U. S. Trust Co.* v. *O'Brien,* 143 N. Y. 284 (1894);
> *A/S Rendal* v. *Arcos, Ltd.,* 106 [N. S.] L. J. K. B. 756 (1937);
> cf. *State Street Trust Co.* v. *Ernst, supra.*

Allocation of the burden of proof will in most cases determine whether the statute or contract involved will give the substance or merely the shadow of the protection it was designed to afford.

By placing that burden on petitioner, the majority of the Circuit Court of Appeals has deprived it of any real protection and relieved respondent of any real responsibility under the Act, or respondent's contract. As Judge Clark in his dissent pointed out (R. 410):

> "* * * Any other rule [i.e., other than the rule for which petitioner contends] seemingly imposes little responsibility upon the Exchange for carrying out the duty which we have found the Act to place upon it, and even provides an incentive, after the Exchange has become

aware of a serious condition, for it to let matters drift, while it and its members having special knowledge protect themselves just as they did here—a result which, to my mind, borders on the immoral, in that it encourages a fiduciary to safeguard its own private interests while it allows its beneficiaries to suffer."

III.

In holding that the New York Stock Exchange was not liable in damages on the sole ground that since the petitioner's securities were pledged on and prior to November 24, 1937, and thereafter were released from pledge for but very short intervals, it was, in the absence of any further showing, a matter of pure speculation whether, if the Exchange had acted on November 24, 1937, the petitioner would have been able to retrieve its securities the Circuit Court of Appeals has decided a question of federal law in a way probably in conflict with applicable decisions of this Court.

Petitioner proved its ownership of the securities it lost, that they were unlawfully pledged on January 26 and 28, 1938, and that all of them were sold to satisfy the loan for which they were pledged.

There can be no doubt, that no matter who had the ultimate burden of proof, petitioner by this proof made out a *prima facie* case for recovery of the full amount of its loss,—that is, that it proved facts entitling it to judgment in that amount, unless additional facts were proved showing that no damage, or a lesser amount of damage had resulted from respondents' wrong.

Certain additional facts were proved:

First, it was proved that petitioner's securities were pledged with banks on November 24, 1937, and on some part of every day thereafter, until their final pledge.

(Plff's Ex. No. 4, R. 250-253.) (But there was no proof as to the amount of the loans for which the pledges were made, the amount of other collateral lawfully pledged to secure them, or even as to whether the pledgees were holders in due course of petitioner's securities. And it was proved that all of petitioner's securities were in the hands of Whitney and his firm during part of the business days between November 24, 1936 and January 26, 1938 on which the loans were paid and the securities repledged. (Plff's Ex. No. 4, R. 250-253; R. 148, 150, 152.))

Second, it was established by the pleadings that Whitney and his firm were insolvent. (But there was no proof as to the extent of their insolvency at any time, as bearing on their ability either to redeem petitioner's securities from previous pledges or to respond in damages. And it was proved that Richard Whitney was able to borrow from his brother George on November 24, 1937, the amount necessary to redeem respondent's securities and repay respondent's cash which he and his firm had misappropriated. And it was also proved that Richard Whitney and Richard Whitney & Co. were able to redeem petitioner's securities from each of their earlier pledges: i.e., by proving that they did in fact redeem them.)

It may be, that the Circuit Court of Appeals unconsciously assumed that "insolvency" might be equated to a complete lack of assets and borrowing ability, and "pledge" equated to certain loss. Its decision not to order a new trial would seem to indicate that something of the sort must have occurred. But the fact remains, that neither of these assumptions can be regarded as axiomatic and there is nothing in the Record to indicate that either, and much to indicate that neither, of them could justifiably be made in the case at bar.

If one wishes to speculate, the more probable assumption is, that some, at least of the earlier pledges would have resulted in no loss at all to petitioner:

In the first place, Whitney and his firm were personally obligated to exonerate petitioner's securities, and if called upon to do so, might have responded, even though insolvent.

In the second place, petitioner was entitled to exoneration or indemnity from securities lawfully pledged along with its securities. In those instances where the security lawfully pledged was enough to cover the loan, the unlawful pledge of petitioner's securities subjected them to no real burden.

As a result of an action commenced in the Supreme Court, New York County, by *The New York Yacht Club* against *Central Hanover Bank and Trust Company, Mary Stevens Baird and others,* whose securities had been lawfully or unlawfully pledged by Richard Whitney with the Public National Bank and Trust Company for loans to him personally, under the authority of *Asylum of St. Vincent de Paul* v. *McGuire,* decided by the Court of Appeals of New York and reported in 239 N. Y. 375 the Yacht Club recovered $31,326.61 of its loss. When the bank foreclosed the loan on the failure of Richard Whitney to pay it, all of the Yacht Club's securities were sold but some of those belonging to Mary Stevens Baird and to others survived the sale. The equitable principles on which the suit was based are expressed in Meyer on "The Law of Stock Brokers and Stock Exchanges", Section 164, page 632, where the learned author said:

> "Where securities belonging to different customers are pledged by the broker, and some are sold by the pledgee in order to satisfy his claim, whereas others which are not needed for that purpose are not sold, the owners of the securities which are not sold must contribute

pro rata to the loss of those whose securities have been sold. The fact that the owners of the sold and the unsold securities originally had no relations with each other, or that no one of them knew that other securities would be pledged with his, as collateral for the same loan, is immaterial. Although securities of the different owners reached the same pledge through separate routes, they finally arrived at the same destination and constituted a common fund, and are forced to share equally in the impairment of that fund. This rule does not rest on contract, or on any principle of joint action or original relationship between the parties whose securities were pledged, but on principles of fundamental justice and equity. It has been invoked by the courts in order that all claimants who are similarly situated may fare equally and that one whose securities through good fortune or through the favor of the pledgee have survived liquidation shall not by that fortuity have an advantage over the others."

The conclusion of the Circuit Court of Appeals (R. 395) that because of the prior pledge of petitioner's securities "we can see no likelihood that the expulsion or suspension of Richard Whitney when the conversions came to the notice of the officers of the Exchange on November 24, 1937, would have in the least benefited the plaintiffs, for the securities were then all converted and in the hands of pledgees" was plainly erroneous.

If all the securities pledged to secure the loan made by the Corn Exchange Bank Trust Company had been illegally pledged, including those owned by the Yacht Club and those owned by the Gratuity Fund of the Stock Exchange, the petitioner could have resorted for contribution to the unsold securities under the equitable doctrine above referred to and if certain of the other securities pledged to secure the

loan were legally pledged, petitioner would have fared better than if all the securities were illegally pledged. We submit that this remedy is in itself a sufficient answer to the assumption that the prior pledge of petitioner's securities necessarily meant a total loss.

In the contribution suit which was actually brought, the Yacht Club recovered as its equitable share of the unsold securities and excess cash derived from the sale of securities which was not required to pay the amount of the loan the sum of $31,326.61. Plainly this recovery cannot benefit the Stock Exchange in this action because of its inequitable conduct in recovering all of the securities and cash belonging to the Gratuity Fund when it learned of Whitney's unlawful actions.

Finally, an illegal pledge imposes no burden at all, unless the pledgee is a holder in due course, as presumptively he is not.

Nevertheless, it must be conceded that proof of these additional facts did create some uncertainty as to the extent of petitioner's damage.

Assuming, for the sake of the present argument, that respondent did not "control" Whitney, and was not required to show that its wrong could not have contributed to petitioner's loss, the burden of going forward with evidence to resolve this uncertainty logically must rest on whichever party should bear the risk of the uncertainty. Since the uncertainty was created by respondent's wrongful act, the decision of this Court in *Story Parchment Co.* v. *Paterson Co.* (282 U. S. 555, 1931) requires that respondent bear this risk, and the decision of the Circuit Court of Appeals placing it on petitioner is, we submit, inconsistent with that decision.

CONCLUSION.

It is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIX

SEC. 2. For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

SEC. 6.(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder;

SEC. 6.(b) No registration shall be granted or remain in force unless the rules of the exchange include provision

for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the wilful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

SEC. 6.(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

SEC. 8. It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly—

SEC. 8.(b) To permit in the ordinary course of business as a broker his aggregate indebtedness to all other persons, including customers' credit balances (but excluding indebtedness secured by exempted securities), to exceed such percentage of the net capital (exclusive of fixed assets and value of exchange membership) employed in the business, but not exceeding in any case 2,000 per centum, as the Commission may be rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors.

(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer

under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer, (2) that will permit such securities to be commingled with the securities of any person other than a bona fide customer, or (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities.

(d) To lend or arrange for the lending of any securities carried for the account of any customer without the written consent of such customer.

SEC. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC. 3.(a) When used in this title, unless the context otherwise requires—

SEC. 14. The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

SEC. 15.(c) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the pur-

chase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

SEC. 20. (a) Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

SEC. 28. (a) The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

(b) Nothing in this title shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on

any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this title or the rules and regulations thereunder.

Rule X-15C 1-2:

(a) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c) (1) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(b) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c) (1) of the Act, is hereby defined to include any untrue statement of material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

Nos. 111 - 112

(14)

IN THE

Supreme Court of the United States

MARY STEVENS BAIRD,

Petitioner,

v.

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Respondent.

THE NEW YORK YACHT CLUB,

Petitioner,

v.

ARTHUR H. FRANKLIN, Treasurer of the New York Stock Exchange, an Unincorporated Association of More than Seven Persons,

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BRIEF IN OPPOSITION TO APPLICATION FOR WRIT OF CERTIORARI

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Opinions Below.

The opinions delivered in the court below are reported in 141 Fed. (2d) 238.

Statement.

These cases were tried by the Petitioners on the theory that, on November 24, 1937, certain facts became known to the respondent (New York Stock Exchange) amounting to notice that Richard Whitney was guilty of conduct requiring prompt action on the part of the Exchange to investigate and suspend or expel Whitney, and that the

failure to do so was a breach of duty owing to the petitioners since they had securities in the hands of Whitney which would or might be dealt with by him in such a way as to cause their loss. The record shows, indeed it was stipulated (Pltf.'s Ex. 4, R. 244, and Exhibit A, R. 250-253; Pltf.'s Ex. 14, R. 261-2 and Exhibit A, R. 267-273), that all of the petitioners' securities had been continuously pledged by Whitney as security for loans made to Whitney or his firm by various banks from a period long before November 24, 1937 until March 8 and 10, 1938 when, upon Whitney's suspension by the Exchange because of insolvency, the securities were sold on foreclosure to satisfy the bank loans. While during this period the securities were released at various times from pledge, it was in every instance for the purpose of pledging them with another bank for another collateral loan on the very same day, and it is obvious from the record that Whitney's possession of the securities was only transitory and merely a step in a shifting of the securities from one bank to another and that the securities were released from pledge at one bank only by the use of money borrowed for that purpose on the same day from another bank.

The Circuit Court of Appeals held that on November 24, 1937, the Exchange violated a duty when it failed to suspend or expel Whitney, "but to justify a judgment in favor of either plaintiff, such a breach of duty must have resulted in damage that can be traced to the breach."

The Circuit Court of Appeals then held that no cause of action had been established, because, as stated in the opinion of the Court:

> "We can see no likelihood that the expulsion or suspension of Richard Whitney when his conversions came to the notice of the officers of the Exchange on November 24, 1937, would have in the least benefited the plaintiffs for the securities were then all converted and in the hands of pledgees.
>
> * * * * *

> "On the record the trial judge would not have been justified in any finding that the plaintiffs suffered damage and he in fact found to the contrary."

ARGUMENT

POINT I.

There is nothing in the decision below to move the Supreme Court to review it.

All that the Circuit Court of Appeals has done in this case is to apply the settled rule of law, that a breach of duty alone without resulting damage does not create a cause of action.

As stated by Judge Cardozo, speaking for the New York Court of Appeals, in *Martin* v. *Herzog*, 228 N. Y. 164, at page 170:

> "We must be on our guard, however, against confusing the question of negligence with that of the causal connection between the negligence and the injury. * * * To say that conduct is negligence is not to say that it is always contributory negligence. 'Proof of negligence in the air, so to speak, will not do' (Pollock Torts [10th ed.], p. 472)."

Surely the reiteration of this established principle and its application in this case does not present any such question as is contemplated by Rule 38 of this Court.

POINT II.

The petitioners' contention with respect to Section 20(a) of the Securities Exchange Act of 1934 is too strained and far-fetched to be worthy of consideration.

The petitioners urge that their point based on Section 20(a) of the SEC Act of 1934 raises an important undecided

question of Federal law. But in reality their argument raises no genuine question, but only proposes a perversion of Section 20(a).

"Controlling person," as that expression is used in Section 20(a), means someone who exercises practical control of a person who, while under such control, injures another. Section 20(a) was designed to deal with the situation where, although the relation of principal and agent or other type of legal control is lacking, one person is made the means of wrongdoing while serving as a screen for another who is able to exercise a practical control, and it is appropriate that the true actor, the one behind the scenes, should be made jointly and severally liable with the ostensible actor.

One or two excerpts from the legislative history of this section are sufficient to show the unsoundness of the petitioners' contention.

At page 6571 (in Part 15) of the printed record of Hearings before the Committee on Banking and Currency, U. S. Senate 73rd Congress, Second Session relating to Stock Exchange practices, is the following explanation given by Mr. Thomas G. Corcoran, one of the drafters of the Act:

> "Without reading those paragraphs, the first is taken verbatim from the Securities Act. The purpose is to prevent evasion of the provisions of the section by organizing dummies who will undertake the actual things forbidden by the section."

In the House debate on the subject as reported in Volume 78, Part 8, of the Congressional Record, at page 8095, Mr. Lea of California explained the provision, in answer to questions, as follows:

> "The object of this provision is to catch the man who stands behind the scenes and controls the man who is in a nominal position of authority."

And again (*ibid.*) he stated:

> "It [the relationship] is just the same position as in the control of a dummy on a directorate. The man who stands behind the scenes and dominates the dummy ought to be responsible because he is the real party in interest."
>
> * * * * *
>
> "It is a question of proving the case in court on the basis of the facts to show that one man did control the other in doing a wrongful thing, and until you have done that there is no punishment or penalty."

Manifestly the members of The New York Stock Exchange are not "dummies" of the Exchange, nor are they persons "in a nominal position of authority" with the Stock Exchange standing behind the scenes and being "the real party in interest". Every member of the Stock Exchange is in business independently for himself and is always the real party in interest.

Petitioners say (p. 12) that "the Courts below did not expressly pass on petitioner's contention, that the respondent exchange was liable jointly and severally with Whitney and his firm, under Section 20(a) of the Act"; but petitioners do (p. 13) "reach the conclusion that the Circuit Court of Appeals must have decided that respondent did not 'control' Richard Whitney and Richard Whitney & Co. within the meaning of Section 20(a)." We agree that this conclusion is inescapable, for petitioners fully briefed their contention under Section 20(a) before the Circuit Court of Appeals, and that court rejected the contention when it held that "The cases were tried on the only possible theory on which recovery could have been hoped for," namely, under Section 6(a) and 6(b) of the Act. (141 F. [2d] 242.)

POINT III.

There is no conflict with any decision of this court or with any decision of any circuit court of appeals.

The petitioners claim that the decision below conflicts with *The Pennsylvania,* 19 Wall. 125 (cited at pp. 3, 16, 17, and 19 of the petition), with *H. W. Bass Drilling Co.* v. *Ray,* 101 Fed. (2d) 316 (cited at pp. 3, 15, and 19 of the petition), and with *Story Parchment Co.* v. *Paterson Co.,* 282 U. S. 555 (cited at pp. 4 and 24 of the petition). Various other cases are cited, apparently to support the idea that there is a conflict, or as having some bearing on the merits.

The Pennsylvania was a case of collision in a fog at sea where the steamer involved was guilty of negligence, and it was a question whether the sailing vessel, which had negligently rung a bell while in motion instead of using a foghorn as she was required by law to do, had thereby contributed causally to the accident. The decision announced a rule of causality applied by the Federal courts sitting in admiralty with respect to violations of statutes designed to prevent accidents at sea (cf. *The Aakre,* 122 Fed. [2d] at pp. 474 and 476), and may not be thought of as having application outside of that field. Furthermore, the case stands for no more than that proof that the sailing vessel violated a rule of maritime law designed to prevent collisions at sea, established negligence on her part, shifting to her the burden of disproving the causal connection between such violation and the ensuing collision (cf., 122 Fed. [2d] at p. 474).

The *Bass Drilling Co.* case presented no question of Federal law. The only issue was the contributory negligence of the driver of a truck because of his violation of a New Mexico statute limiting the speed of trucks to 45 miles an hour. It was shown that the truck was traveling in excess of 45 miles an hour at night when it collided with defendant's truck parked in the

highway. Therefore, under the circumstances, there was a natural inference of a causal connection between the violation of the statute, which the Court held to be negligence *per se*, and the collision. The question before the Court was whether the jury had been properly instructed that violation of the statute was negligence *per se* and that the burden shifted to the plaintiff to disprove causal connection between the violation of the statute and the ensuing collision with the defendant's truck. In the present case there can be no inference of causal connection since it appears from the stipulated proof that the performance of the respondent's duty would only have resulted in their being sold on foreclosure shortly after November 24, 1937, instead of at the later time; and this was the reason why the Circuit Court of Appeals found that there was "no likelihood that the expulsion or suspension of Richard Whitney * * * would have in the least benefited the plaintiffs". The *Bass Drilling Co.* case presents no fact comparable to the affirmative proof in the present case that the securities had been converted and pledged for bank loans from a time long before November 24, 1937, and would only have been foreclosed and sold sooner instead of later if the alleged duty had been performed.

The *Story Parchment Co.* case was an action for damage claimed to have resulted to the plaintiff from a conspiracy in restraint of trade to drive down prices. The damages were to be measured by the difference between the prices received by the plaintiff during the period concerned and the prices it would have received had prices not been driven down. The defendant's action in driving down prices had made it impossible to demonstrate what the prices would otherwise have been. The fact of whether damage to the plaintiff had been caused was not in the least in doubt, and the alleged failure of proof as to damages related exclusively to the difficulty of assessing the amount of the damages.

POINT IV.

The petitions for writs of certiorari should be denied.

Respectfully submitted,

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